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C O N F I D E N T I A L SECTION 01 OF 04 KUWAIT 001214

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STATE FOR NEA/ARP, EB, TREASURY FOR STEVE WINN AND KARTHIK
RAMANATHAN, LONDON FOR TSOU, PARIS FOR ZEYA

E.O. 12958: DECL: 04/08/2016
TAGS: ECON EFIN PGOV PREL KU
SUBJECT: TREASURY UNDERSECRETARY RANDAL QUARLES MEETS WITH
GOK AND BANK OFFICIALS TO DISCUSS US MARKETS AND REGIONAL
TRENDS

REF: A. KUWAIT 850

¶B. KUWAIT 587
¶C. KUWAIT 437
¶D. 05 KUWAIT 638

Classified By: CDA Matthew Tueller. Reasons 1.4 (b) and (d)

¶1. (C) Begin Summary: During separate March 21 meetings with Treasury Undersecretary Randal Quarles, GOK and Kuwaiti banking officials expressed confidence in the U.S. economy's mid-term vitality, predicted sustained levels of investments in U.S. Treasuries, inquired about the impact on the U.S. economy in the face of competition from emerging markets (China/India), criticized the USG for politicizing the Dubai Ports World deal, voiced concerns about the U.S. deficits (fiscal/current account), called for urgent economic reforms in Kuwait, and urged a slower and more focused pace of democratic reforms in the Middle East. End summary

¶2. During his day of meetings on March 21, Treasury Undersecretary for Domestic Finance Randal Quarles met with the GOK Finance Minister, the Managing Director of the Kuwait Investment Authority (KIA), the Governor of the Central Bank of Kuwait, the Director General of the Public Institution for Social Security (PIFSS), and the Chairman of the Commercial Bank of Kuwait (country's second largest--see ref D) to discuss U.S. and regional economic developments and emerging trends impacting investor (public and private sector) attitudes toward the U.S.

U.S. Markets Still Attractive

¶3. (C) There was general agreement among the interlocutors about the continued attractiveness and profitability of the U.S. economy and investment market, particularly U.S. Treasury securities and dollar-denominated assets. Finance Minister Bader Al-Humaidhi underscored GOK confidence in the U.S. economy and predicted sustained levels of GOK investment (through the KIA) in the U.S., including Treasury securities, as part of the GOK's long-term investment strategy in a market it considers to be low risk, transparent, and profitable. Both Al-Humaidhi and KIA Managing Director Al-Saad downplayed the possibility of any major shift or reallocation of GOK investments from the U.S. to emerging markets such as China or India.

¶4. (C) Al-Saad and Al-Humaidhi urged renewed cooperation in addressing GOK concerns about withholding and capital gains taxes affecting Kuwaiti investors interested in the U.S. real

estate market. Al-Humaidhi acknowledged the USG's own corporate tax problems in Kuwait and reaffirmed the GOK's commitment to address those problems through anticipated legal reforms (see ref B). U/S Quarles noted the GOK's interest in a bilateral tax treaty to address real estate related tax problems and agreed to convey this interest to the tax officials at Treasury.

¶5. (C) Al-Saad echoed Al-Humaidhi's optimism about the medium-term viability of the U.S. economy. He was unsure what impact emerging markets would have over the long-term, including on the U.S. economy's ability to retain its dominant role as the global driving force. He hinted at the likelihood of some shift in GOK assets toward emerging markets, but praised the U.S. economy and reaffirmed KIA's continued interest in U.S. Treasury securities and dollar-denominated assets, including the relatively new Treasury Inflation Protected Securities (TIPS) and other fixed income investments.

¶6. (C) According to Al-Saad, more than 60% of KIA's U.S. investments are in dollar-denominated assets. He expressed satisfaction with the level of liquidity present in the U.S. Treasuries market. U.S. Treasuries, rather than Agency Securities such as Freddie Mac or Fannie Mae, were still a larger share of GOK investments, he said. Al-Humaidhi and Al-Saad stressed that GOK (KIA) investments in the U.S. were managed by independent fund managers not subject to direct GOK intervention but instead to general KIA guidance on investment preferences. Al-Saad expressed confidence in the fund managers' continued positive performance and the expected positive returns from the U.S. market.

¶7. (C) PIFSS Director General Al-Rajaan said that his organization (second largest GOK investment agency after KIA)

invests largely in G7 countries, operating through fund managers and not through direct investment. He pointed out that 2% of PIFSS's expected $2 billion cash influx from the GOK would be invested in U.S. Treasuries. As the GOK's main pension fund and arguably the world's most generous pension system, PIFSS focused on long-term investments with minimal risk and predictable returns, he added (see ref C for an overview of PIFSS).

Concerns About U.S. Twin Deficits

¶8. (C) Al-Saad and Central Bank Governor Shaykh Salem AbdulAziz Al-Sabah inquired about the status of U.S. economic indicators including the GDP, interest rates, possible inflationary pressures impacting the USG's ability to address its twin deficits at a time of increased global imbalances. Both voiced concerns with the prevailing U.S. twin deficits (fiscal and current account) and inquired about USG strategies to address them, noting that press reports critical of the USG's efforts were undermining investor confidence. Al-Sabah suggested that a more aggressive USG public awareness campaign could help alleviate investors concerns. He noted that the U.S. current account deficit was almost a mirror image of the current account surpluses of oil producing economies.

¶9. (C) U/S Quarles explained the USG's deficit reduction strategy and intentions to cut the deficit in half as a percentage of GDP by 2009. He agreed with Al-Sabah about the importance of demonstrating a credible strategy to control and reduce the respective deficits, and noted that such a plan has been in place. The U.S. fiscal situation was continuing to improve through continued deficit reductions as a percent of GDP, despite negative press reports, U/S Quarles said. Revenues were at an all time high with a 3.4% GDP growth rate in 2006 and 3.3% growth rate projections over the next three to four years starting in 2007. Inflationary pressures were absent for the time being but subject to

change with the influx of cheap labor from China and India into the global market.

¶10. (C) U/S Quarles explained that the U.S. maintained a low debt to GDP ratio, unlike other major economies, thereby making a budget deficit more sustainable over the long-term. He added that the budget deficit was also contributing to a fiscal stimulus in the global economy and contributing to low interest rates as a result of effective deficit management. He underscored USG concerns with China's continued accumulation of foreign reserves and the risks associated for China and the negative impacts on the global market. The USG was actively engaging China and seeing increased flexibility from Beijing in addressing this matter, he added.

Dubai Ports World Deal An Unfortunate Result for the U.S.
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¶11. (C) All five interlocutors lamented the demise of the Dubai Ports World (DPW) takeover bid as a strike against U.S. credibility among investors, particularly Arab investors. Al-Humaidhi predicted a lessening of investor confidence and enthusiasm for the U.S. markets among private Kuwaiti investors, commenting that "Kuwaitis were surprised by the U.S. approach." Al-Rajaan criticized the U.S. for mismanaging the issue and aggravating Arab misperceptions of anti-Arab and anti-Islamic sentiment in the U.S. Commercial Bank of Kuwait Chairman Abdulmajeed Al-Shatti commented that the U.S. reaction "was too extreme" and that the media was exploiting U.S. public misperceptions and misguided fears of Arabs and Muslims. (Note: None of the interlocutors said that the DPW would influence their investments in U.S. debt instruments or direct investments.)

¶12. (C) Al-Saad added that the Dubai Ports issue would likely impact the United States' reputation as an open market. He expressed concern about the fate of potential GCC plans to invest in oil refineries in the U.S. given the recent DPW experience and the President's State of the Union remarks about U.S. energy dependencies, asserting that a similar U.S. political response could undermine the GCC's otherwise steadfast commitment to its U.S. business dealings.

¶13. (C) U/S Quarles reassured his interlocutors that the DPW

incident was not a model or a new trend toward U.S. protectionism aimed at discouraging investments from the Arab and Muslim world. He expressed disappointment with the deal's outcome amidst politicization based on misplaced national security concerns. U/S Quarles commented that the DPW outcome may have been different had the company's U.S.-based advisors embarked on a more targeted and strategic information awareness campaign at the outset with U.S. officials from impacted States to preemptively address their concerns.

¶14. (C) However, the risk of politicizing such deals, including potential GCC oil refinery investments remains, U/S Quarles added, pointing to the recent failed Chinese takeover attempt of UNOCAL. There was an effort underway by the USG to minimize the likelihood of political manipulation through a more streamlined and comprehensive national security review process, he added.

Region Booming But In Need of Economic Reforms
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¶15. (C) Regarding emerging regional economic trends, Al-Sabah identified the oil market's boom, infrastructure development, and heightened GCC interest in creating financial centers as key factors impacting the pace and scope of the region's resurgent economy. He pointed to lingering concerns about the situation in Iraq, but noted that

historically, regional instability, including the ongoing Iranian nuclear stand-off, ironically resulted in regional market gains. However, direct investment in Iraq and Iran would remain on hold for the foreseeable future given the questionable security, political and economic conditions affecting those two countries, he opined.

¶16. (C) Al-Shatti commented that Saddam's removal, regional market booms, high oil prices and the substantial U.S. military presence all contributed to regional prosperity. He added that Iraq's unstable security situation prompted many regional investors to redirect their investments to Jordan, Lebanon and other GCC countries. Chinese investments in the region were also on the rise, he pointed out.

¶17. (C) Al-Rajaan, a self-described pro-American (educated at American University in Washington, DC) cautioned against "pushing too hard and too fast" for democratic reforms in the Middle East, suggesting that democratic reforms, in order to be effective and lasting, needed time to evolve. He criticized the USG's policies in the region, notably in Iraq, and the impact those policies were having on the Arab public mindset. He added that the Middle East was a "critical and sensitive region" that was not suited for U.S. solutions imposed in haste and lacking in cultural sensitivity. He urged greater U.S. openness with its opponents, including greater engagement with Iran, particularly through academic and cultural exchanges for Iranian youth to alter their mindset about the U.S.

¶18. (C) Al-Sabah explained that Kuwait's democratic institutions, human resources, and extensive financial experience afforded the country a unique opportunity and advantage over other GCC competitors in establishing a more viable and comprehensive financial center. He acknowledged the need for implementing urgent economic reforms to catapult Kuwait into the international financial arena beyond its historic role as an energy powerhouse. He expressed heightened optimism and confidence in the new Amir's commitment to implementing reforms, and noted that reforms would be based on individual issues and requirements. Al-Rajaan was critical of the slow pace of reforms and called for more top-down pressure to implement them. He praised Kuwaitis for their dynamism and institutions, but criticized the government for mismanaging privatization efforts.

¶19. (C) Al-Sabah concurred with the Ambassador on the need to establish a Capital Markets Authority (CMA) to regulate the Kuwait Stock Exchange (KSE), particularly following the KSE's recent correction (ref A). Al-Shatti praised the KSE's long-standing reputation and experience as one of the more reliable and better regulated GCC markets. However, Al-Sabah criticized the lack of Kuwaiti understanding and awareness of a CMA. He said that "there is a lot of talk, but there is little understanding" among Kuwaiti CMA proponents about how to establish a functional CMA that meets Kuwait's unique needs. Every CMA or its equivalent around the world has

different forms, functions, and powers, he added. There needed to be a better understanding of these complexities before moving ahead, he cautioned.

¶20. (U) U/S Quarles has cleared this cable.

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